Supreme Court, U.S.
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No.

In The

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1994

BUD MCLAUGHLIN,

Petitioner,

v.

STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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62 pp

QUESTION PRESENTED

1. Whether a federal circuit court which re-weighs evidence and judges witness credibility contrary to a jury's determination violates the Seventh Amendment and the decisions of this Court.

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The petitioner, Bud McLaughlin, respectfully prays that a writ of certiorari issue to review the judgment and order of the United States Court of Appeals for the Seventh Circuit entered on July 26, 1994, reversing the jury verdict rendered in the United States District Court for the Northern District of Indiana, Hammond Division, and the judgment entered upon said verdict which awarded punitive damages to the petitioner.

OPINIONS BELOW

The decision of the United States Court of Appeals for the Seventh Circuit, affirming in part and reversing in part the jury verdict and judgment of the district court, appears in the Appendix hereto. The decision is also reported at 30 F.3d 861 (7th Cir. 1994). The order denying petitioner's motion for rehearing appears in the Appendix hereto and is reported at 30 F.3d 861 (7th Cir. 1994).

The unreported jury verdict and judgment thereon entered by the district court are included in the Appendix as well.

JURISDICTION

The Judgment and decision of the United States Court of Appeals for the Seventh Circuit were entered on July 26, 1994. Petitioner filed his petition for rehearing in that

court on August 9, 1994. The Order of the United States Court of Appeals for the Seventh Circuit denying the petition for rehearing was entered on September 8, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254 (1).

CONSTITUTIONAL PROVISIONS INVOLVED

The Seventh Amendment to the Constitution of the United States of America:

> In suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law.

STATEMENT OF THE CASE

On September 18, 1991, Bud McLaughlin (hereinafter "McLaughlin") filed his complaint in two (2) counts against State Farm Mutual Automobile Insurance Company (hereinafter "State Farm"). Count I alleged that State Farm had breached the contract of insurance between the parties by failing to pay McLaughlin the value of his 1990 International flat-bed truck and the special fish hauling equipment on it which were destroyed by fire on October 13, 1990, when the insurance policy was in effect. Count II alleged that State Farm's conduct in its handling and denial of McLaughlin's fire loss claim

constituted fraud, malice, gross negligence or oppression thereby entitling McLaughlin to punitive or exemplary damages. McLaughlin also requested a trial by jury.

The complaint was filed in the Indiana State Court and removed to the United States District Court for the Northern District of Indiana, Hammond Division, upon motion of State Farm pursuant to 28 U.S.C. Section 1441 and 28 U.S.C. Section 1332 (a). McLaughlin was an Indiana resident and State Farm was an Illinois corporation.

The jury trial commenced on January 4, 1993, and lasted through January 12, 1993. State Farm's motions for judgment on the evidence and for a directed verdict were denied. The jury returned a verdict in favor of McLaughlin, awarding compensatory damages of $26,592.00 and punitive damages of $150,000.00. Judgment upon the verdict was entered by the court on January 12, 1993.

The jury was presented with evidence at trial through eighteen (18) witnesses, which included every claim representative and supervisor of State Farm who worked on McLaughlin's claim. It had the opportunity to watch the demeanor of each witness and to assess each witness's credibility. The evidence at trial showed that the fire loss occurred on October 13, 1990, and was discovered by a Newton County Sheriff at 1:25 a.m. (Tr. pp. 729-730; Pl's. Exh. 23). That day when McLaughlin returned from a hunting trip he had been on with several other hunters in Attica, Indiana, he learned of the fire and

called his State Farm insurance agent, Mick Gapen, to report it. (Tr. pp. 473-475). Mr. Gapen was out of town that Saturday so McLaughlin again called him the following Monday, October 15, 1990. (Tr. pp. 473-475; Pl's. Exh. 48). The jury heard how State Farm construed this as a failure to give it prompt notification of his loss. (Tr. pp. 911-912; 150-151).

The jury heard testimony from State Farm that on the first day that it handled this loss claim, it began its search for a reason to deny McLaughlin's claim. The paperwork to create the claim file was prepared by State Farm on October 22, 1990, and its first entry in the activity log was to look for a "motive" on the part of McLaughlin. (Tr. pp. 952-955; Pl's. Exh. 45). It made this entry after its estimator went to see the burned truck and where McLaughlin lived. (Tr. pp. 952-953). Knowing nothing of McLaughlin, his finances, prior loss claims, or anything else other than where he lived and the conditions under which he lived, State Farm's claim superintendent flagged the file with a directive to his claim representative, Brian Biery: "BRIAN---SEE ME!" (Tr. pp. 954; Pl's. Exh. 45). It was this directive that prompted the very first entry into State Farm's activity log re: look for motive, run a credit check on McLaughlin, and get a cause and origin report. (Tr. pp. 952-953). The jury also heard the testimony of what State Farm did and did not do in its "investigation" of this claim.

State Farm began its single-minded objective of denying McLaughlin's claim by focusing on the broken

drive shaft of his truck to prove that there was prior damage to the vehicle. (Tr. p. 951; Pl's. Exh. 45). However, when the fire origin expert employed by State Farm could not support pre-existing damage as a "motive", it next told McLaughlin there was a question about whether he had insured $13,000.00 worth of fish-hauling equipment. (Tr. p. 502). The jury heard, too, that this was indeed curious because State Farm's agent who placed the insurance had already confirmed such coverage on the very loss claim documents the claims representative, Brian Biery, had in his hands. (Pl's. Exh. 26). McLaughlin brought in his policy endorsement for the fish hauling equipment and heard no more from State Farm about any coverage problem. (Tr. pp. 502-503; 707-709; Pl's. Exh. 74).

State Farm then utilized its resources to turn to its final tact; investigate McLaughlin and record unverified, erroneous financial information adverse to him, distort the time frame of the fire and McLaughlin's whereabouts, ignore any information that verified his claim, and create false memorandums stating McLaughlin lied about the events surrounding the loss. The jury heard how State Farm went about this task. It gathered all of his financial records and prior divorce records and concluded that McLaughlin owed $5,121.00 to his ex-wife in court ordered payments, owed $516.00 on a vehicle he owned, and owed $233.00 on a J.C. Penney charge account. (Tr. pp. 971-974). McLaughlin, according to State Farm, had a financial motive for burning his truck. But the jury

also heard how State Farm never provided a copy of these records to McLaughlin or asked him to explain any of those alleged debts (Tr. p. 973); never asked anyone what the divorce records really meant or even attempted to learn that McLaughlin had paid what was owed to his ex-wife almost a year before the fire (Tr. p. 979; 965); never asked either McLaughlin or his ex-wife about the J.C. Penney credit card debt which was her account and not his; and never made any effort to find out that the $516.00 owed on his vehicle was the result of a finance company taking out insurance on it because State Farm failed to provide it with the necessary proof of insurance documentation. (Tr. pp. 520-522). In fact, the evidence showed that State Farm did absolutely nothing to determine the accuracy of the information it gathered. (Tr. p. 965). Even more startling was the testimony the jury heard about arrangements McLaughlin and his wife made to obtain money from family members to sustain them while they prepared to operate his new pay lake business, how the loan was already in process before the fire, how he told State Farm of the loans and the family members involved, and how State Farm not only ignored this information but did not even write it down in its activity log. (Tr. pp. 1011-1012).

With respect to State Farm's manipulation of the time of the fire and its creation of false memos, the jury heard that the fire chief told State Farm the fire began a half hour before it was discovered at 1:25 a.m., but the claim representative wrote in his report that the fire occurred

between 12 midnight and 1:00 a.m. (Pl's. Exh. 26; Tr. p. 1064; Pl's. Exh. 49). This "enlarged" time frame allowed State Farm to say McLaughlin was in the vicinity of the fire instead of well on his way to Attica, Indiana, as two (2) other witnesses so testified. It heard that McLaughlin's ex-wife told State Farm she did not know what fish hauling truck (hers or McLaughlin's) he used the day before the fire, but the State Farm claim representative reported that she "is quite clear that he used his own truck to make the delivery" that day. (Tr. p. 1066; Pl's. Exh. 49). This fabrication then allowed State Farm to say McLaughlin was making false statements to it. The jurors heard that the claim representative included in his file a memo he created saying he caught McLaughlin in a direct contradiction in his sworn statement under oath because he said his wife was not at home when the fire occurred. (Tr. p. 1039; Pl's. Exh. 50). However, the source of the "contradiction", Gene Perry, never said any such thing. (Tr. p. 831). The jury heard evidence as to the efforts taken by State Farm to come up with a "false statement" made by McLaughlin. For example, when he told them about his fish hauling business, he said he had missed bidding in 1990 on Lake County, Indiana, parks contracts for stocking its ponds with fish because his fish hauling tanks were delivered late and that he was sure he "could have got" those contracts in 1991 with his new truck. (Tr. pp. 1031-1032; Pl's. Statement Under Oath, pp. 21-22, 34-35; Def's. Exh. 12). State Farm, however, testified that he told them he

had the contracts. (Tr. pp. 1029-1032). Such a distortion of McLaughlin's statement then became a basis for State Farm's denial of his loss claim because it claimed he made "misrepresentations" of material facts.

The jury received a plethora of evidence from which it could conclude that State Farm acted in bad faith during the five (5) months it handled McLaughlin's loss claim. It admitted that its duty to its insured was to give McLaughlin's claim as much consideration as it gave its own interests. (Tr. p. 902). It admitted that it had no written guidelines for handling a vehicle fire loss claim, no written guidelines to determine what facts should be gathered or how they should be recorded, no written guidelines for ordering credit reports or verifying the information in them, no written guidelines for obtaining background reports on an insured, and no written guidelines or procedures for documenting its investigation. (Tr. pp. 856-858; 899-900). It admitted that McLaughlin cooperated with it throughout its investigation; that he provided it upon request with signed authorizations, statements, tax returns, and loss verification documents; and that he even offered to take a lie detector test if State Farm wanted one. (Tr. pp. 960-962; 966-967; 959; 567-568; 309-310; Pl's. Exh. 42). It admitted that it knew McLaughlin was dependent upon his truck for his livelihood. (Tr. pp. 968). In response to this cooperation, the jury heard how State Farm never told him it suspected him of arson, never told him of the credit report information, never told him of the divorce

court records, never verified any of the information given to it by McLaughlin, and never gave McLaughlin an opportunity to explain any of it. (Tr. pp. 963; 972-973; 846; 851-852; 918, 1011-1012). Moreover, when State Farm finally wrote to advise it had denied his $43,000.00 loss claim, it failed to tell McLaughlin the factual basis for the denial or even what it contended McLaughlin was supposed to have falsely stated or misrepresented. (Tr. pp. 1074-1075). State Farm refused to provide any factual basis for the denial even when McLaughlin hired a lawyer who specifically wrote and asked for it. (Tr. pp. 902-908). And despite the denial of the claim, State Farm then paid $19,878.07 of it directly to the finance company to pay off the loan McLaughlin had taken out to purchase the truck. (Tr. p. 1080). State Farm never even told McLaughlin of this payment. (Tr. p. 1081). For that matter, State Farm never sued McLaughlin to recover the money it paid to the finance company and it never provided any evidence or facts to the fire chief regarding even a suspicion that McLaughlin was involved in the burning of his truck. (Tr. pp. 1082-1084).

Finally, the jury heard evidence that the handling of McLaughlin's claim would not be done fairly and in good faith if State Farm misrepresented pertinent facts about coverage, if it failed to act reasonably promptly upon communications with respect to his claim, if it failed to conduct a reasonable investigation based upon all available information, and if it refused to provide McLaughlin with a factual basis for the denial of his claim.

(Tr. pp. 902-908). The jury heard evidence on each of those issues and ultimately concluded that there was clear and convincing evidence that State Farm's conduct was punitive. Clear and convincing evidence, as the jury was instructed by the Court, meant that each and every element of McLaughlin's punitive damage claim had to not only be proven by more than a preponderance of the evidence, but also that such evidence had to exclude wrongful conduct by State Farm that was merely the result of a mistake of fact or law, honest error of judgment, overzealousness, mere negligence of some other type of non-willful human failing. (Court's Instruction Nos. 24, 25, 26, 27).

The jury determined those factual issues and resolved the issues of witness credibility. It returned a punitive damage verdict against State Farm. The trial court judge, who also heard the evidence and viewed the demeanor of the witnesses while they testified, likewise resolved those issues in favor of McLaughlin when he denied State Farm's Motions for Judgment on the Evidence and for a Directed Verdict.

State Farm appealed the verdict to the United States Court of Appeals for the Seventh Circuit pursuant to U.S.C. Sections 636, 1291 and 1332. It raised the sufficiency of the evidence. The Court of Appeals disregarded the evidence produced by McLaughlin and ignored the inferences derived from that evidence. The Court of Appeals disregarded, too, the jury's right to determine whether State Farm's proffered reasons for the

denial of McLaughlin's claim were credible. In so doing, the Court of Appeals for the Seventh Circuit presented a factual setting taken from State Farm's recitation of facts which included things like McLaughlin owing his ex-wife thousands of dollars, having credit card debt, and being delinquent on vehicle payments for his van...the very factual issues the jury had already resolved. It also recited "facts" like McLaughlin's trailer being repossessed, but omitted that such action came up months after the fire loss and as a result of McLaughlin telling the contract seller of the trailer to come and get it because the seller had misrepresented its condition when he sold it to McLaughlin. (Tr. pp. 237-140; 821-823). Perhaps most glaringly absent from the Court of Appeals decision was its omission that State Farm never had any fire report, cause and origin report, or fire marshall's investigative report which even hinted that McLaughlin was involved in the fire (Tr. pp. 734; 1003; 1027); that numerous witnesses accounted for McLaughlin's whereabouts from 7 p.m. the evening before his truck burned through the afternoon following the loss (see testimony of Roger Clark, Melvin Dobson, Gene Perry, Bud McLaughlin); that State Farm never gave McLaughlin an opportunity to controvert State Farm's erroneous interpretation of financial records and divorce pleadings; that State Farm never attempted to verify McLaughlin's financial condition with the family members he told them of (Tr. pp. 972-973; 1011-1012); that State Farm utilized its "investigation" from the very first day to look for a

reason to deny his claim; and State Farm never even obtained any comparables, depreciation figures or values for McLaughlin's truck and equipment. (Tr. 930; 943). These factual matters omitted by the Court of Appeals constituted State Farm's "right to disagree" defense which it presented to the jury and had the trial court instruct the jury on the applicable law. (Final Instruction No. 17; Pleadings Vol. 3). The jury rejected this defense after hearing all the evidence and judging the demeanor of the witnesses. Notwithstanding, the Court of Appeals reversed the jury's determinations and vacated the punitive damage award.

It is the review of such jury determined facts and issues by the Court of Appeals for the Seventh Circuit which McLaughlin now asks this Court to address by the issuance of a Writ of Certiorari.

REASONS FOR GRANTING THE WRIT

Since the passage of the Bill of Rights, the Supreme Court has been vigorous in its defense of the seventh amendment and the jury's exclusive province to determine factual disputes. That vigor appears to have waned in the recent past, not by this Court's express holdings, but by its silence. The result of that silence has allowed the circuit courts a virtual unfettered review de novo of the evidence at trial; a review unknown at common law and never envisioned by the drafters of the seventh amendment. It is time for the Supreme Court to once more speak loudly and clearly on the extent of

appellate review of jury determined issues if the right to trial by jury in a civil case is to survive.

I.
THE SEVENTH CIRCUIT'S STANDARD OF REVIEW OF A JURY VERDICT AND A TRIAL COURT'S DENIAL OF A MOTION FOR JUDGMENT N.O.V. IS CONTRARY TO THE SEVENTH AMENDMENT AND THE MANDATES OF THIS COURT.

The role of the jury in a civil proceeding is clear: "In the federal system, the Constitution itself commits the trial of facts in a civil cause to the jury. Should either party to a cause invoke its Seventh Amendment right, the jury becomes the principal fact-finder, charged with weighing the evidence, judging the credibility of witnesses, and reaching a verdict. The jury's factual determinations as a general rule are final."

Edmonson v. Leesville Concrete Co., 500 U.S. , 114 L.Ed.2d 660, 676, 111 S.Ct. 2077 (1991); Bashan v. Pennsylvania R. Co., 372 U.S. 699 (1963). At common law, there was no method for challenging the sufficiency of the evidence. With the advent of directed verdicts and judgments n.o.v., the Courts were allowed to review the evidence within the parameters of the constitutional limitations imposed by the Seventh Amendment. This Court's decisions which previously held that a review of

a jury verdict for sufficiency of the evidence was an impermissible request "to transcend the limits prescribed to our action on questions of fact" Hepburn v. Peters, 37 U.S. (12 Pet.) 345 (1838), then permitted only a limited review:

> "Only when there is a complete absence of probative facts to support the conclusion reached does a reversible error appear...[T]he appellate court's function is exhausted when [an] evidentiary basis becomes apparent, it being immaterial that the court might draw a contrary inference or feel that another con-conclusion is more reasonable."

Lavender v. Kurn, 327 U.S. 645 (1946). Since Lavender v. Kurn, this same standard of review has been announced consistently by the High Court. Bashan v. Pennsylvania R.R., supra; Dennis v. Denver & Rio Grande W. R.R., 375 U.S. 208 (1963).

This Court has also spoken to various constitutional safeguards with respect to the limits to be placed on even a review of the "complete absence of probative facts" standard. For example, in Aetna Life Insurance Co. v. Ward, 140 U.S. 76 (1891), this Court held that jurors alone were to evaluate the demeanor and credibility of witnesses. This directive was repeated in subsequent cases. Lavender v. Kurn, supra; Bose Corp. v. Consumers Union, 466 U.S. 485 (1984). The reason for such a rule was stated by jurist Learned Hand years ago when he wrote that a witness's bearing on the stand may

convince a jury

> ..."not only that the witness' testimony is not true, but that the truth is the opposite of his story; for the denial of one, who has a motive to deny, may be uttered with such hesitation, discomfort, arrogance or defiance, as to give assurance that he is fabricating, and that, if he is, there is no alternative but to assume the truth of what he denies."

Dyer v. MacDonald, 201 F.2d 265, 269 (2nd Cir. 1952). Likewise, ambiguities in the testimony of witnesses are to be resolved by the jury and not by appellate review. Anderson vs. City of Bessemer, 470 U.S. 564 (1985).

Unfortunately, the Seventh Circuit has not adhered to either the constitutional mandate of the seventh amendment or the admonitions of this Court. To the contrary, it has expressly disapproved of the "no evidence" standard and it has implemented its own sufficiency of the evidence standard of review. In LaMontagne v. American Convenience Products, Inc., 750 F.2d 1405 (7th Cir. 1984), the Seventh Circuit held that evidence which supported a jury's verdict but was, in that court's view, "merely suggestive" was insufficient under its "substantial evidence" standard. Such a holding appears to be in direct contravention of the common law rule implanted by the seventh amendment which permitted "circumstantial evidence only slightly tending to prove a fact." Pickel v. Isgrigg, 6 F. 676, 678 (C.C.O. Ind.

1881). Even beyond such a direct contradiction, however, the Seventh Circuit in LaMontagne also rejected this Court's directive to allow jurors to determine witness credibility by holding that, in the absence of some substantial evidence to the contrary, "a reasonable jury could not reject [the defendant's] plausible account."

The Seventh Circuit appears to routinely take over the function of the trier of fact. In Estate of Davis v. Johnson, 745 F.2d 1066 (7th Cir. 1984), it rejected as unreliable testimony that a jail supervisor could have heard the beating being given to the plaintiff inmate. In Gonzalez v. Volvo of America Corp., 752 F.2d 295 (7th Cir. 1985), it determined, contrary to the jurors conclusion, what the expectations were of ordinary consumers and that the Volvo at issue was therefore not dangerous beyond those expectations. In Delvaux v. Ford Motor Co., 764 F.2d 469 (7th Cir. 1985), it asserted that a jury's verdict was "speculative," notwithstanding this Court's admonition in Lavender v. Kurn when it reversed the state appellate court which overturned a plaintiff's jury verdict and stated:

> "[I]t is no answer to say that the jury's verdict involved speculation and conjecture. Whenever facts are in dispute or the evidence is such that fair minded men may draw different inferences, a measure of speculation and conjecture is required on the part of those whose duty it is to settle the dispute by choosing what seems to them to be the most reasonable inference."

Lavender v. Kurn, 327 U.S. 645, 653 (1946). And in U.C. Castings Co. v. Knight, 754 F.2d 1363 (7th Cir. 1985), it reviewed the evidence de novo and applied a "reasonableness" standard to determine if the size of an award should stand.

The Seventh Circuit Court of Appeals has also departed from the standards set down by this Court when reviewing a trial court's denial of a motion for judgment n.o.v. This Court previously stated that appellate judges were required to give substantial deference to the trial judge's view of the sufficiency of the evidence, and additionally, that the trial judge should have preeminent responsibility for deciding whether a defect in the evidence was so serious as to require a judgment n.o.v. Patton v. Texas & Pacific Railway Co., 179 U.S. 658 (1901); Dick v. New York Life Ins. Co., 359 U.S. 437 (1959). Contrary to such directives, however, the Seventh Circuit appears to have rejected giving any deference to the trial court judge and, instead, reviews the evidence and witness credibility de novo. Spanish Action Comm. of Chicago v. City of Chicago, 766 F.2d 315 (7th Cir. 1985); Tice v. Lampert Yards, Inc., 761 F.2d 1210, 1213 (7th Cir. 1985).

In the present case, the Seventh Circuit has again performed a review of the jury's verdict and the trial court's denial of State Farm's motion for judgment n.o.v. in violation of the seventh amendment and this Court's decisional law. The magnitude of these violations is apparent from a review of its opinion.

The Seventh Circuit first addressed State Farm's claim that it should have been awarded a summary judgment on the punitive damage issue. State Farm Mut. Auto. Ins. Co. v. McLaughlin 30 F.3d 861 (7th Cir. 1994); Appendix hereto, A-14. McLaughlin does not quarrel with the standard of review applied by the appellate court; a review de novo to determine whether there was no genuine issue as to any material fact and that the moving party was entitled to judgment as a matter of law correctly states the standard under Federal Rule of Civil Procedure 56(c). Nor does McLaughlin quarrel with the heightened "clear and convincing" standard of proof to which the Seventh Circuit held him on the summary judgment issue pursuant to Indiana's punitive damage law. Anderson v. Liberty Lobby, 477 U.S. 242, 251 (1986). Indeed, the gravamen of such a review and the Seventh Circuit's resolution of it in McLaughlin's favor would logically mean that at trial, if the jurors resolved the factual issues in dispute in McLaughlin's favor by finding the evidence on those issues to be clear and convincing, McLaughlin must necessarily be entitled to judgment on his punitive damage claim. The jury was instructed that the law required no less:

> "In order for a jury to consider awarding punitive damages, the plaintiff must prove each and every element of his claim for punitive damages by clear and convincing evidence. The clear and convincing evidence standard is an intermediate

> standard, requiring more than a preponderance of the evidence, less than beyond a reasonable doubt, and requires that the existence of a fact be highly probable.
>
> To satisfy the clear and convincing evidence standard, the evidence must exclude every reasonable hypothesis that the defendant's actions were motivated by innocence. Thus, in a claim for punitive damages, the clear and convincing standard requires evidence that the alleged wrongful conduct was not the result of a mistake of fact or law, honest error of judgment, overzealousness, mere negligence of other types of non-willful human failing. Therefore, unless the plaintiff presents clear and convincing evidence which shows that the conduct complained of resulted from something other than a mistake of fact or law, honest error of judgment, overzealousness, mere negligence or some other type of non-willful human failing, that conduct cannot be the basis for an award of punitive damages.

(Courts Instruction No. 26, Pleading Vol. 3 of Record on Appeal). Since the Seventh Circuit held that State Farm's summary judgment request was properly denied because it was the province of the jury to resolve the disputed factual issues, and since the jury in fact resolved those issues in McLaughlin's favor, the only means by which

the Seventh Circuit could negate the juror's verdict would be by impermissibly reweighing the evidence, judging the credibility of the witnesses, and substituting its judgment for that of the jury. This is exactly what the Seventh Circuit did.

Without citing to any authority or even announcing its standard of review, the Seventh Circuit spends less than two (2) pages of its Opinion reciting its version of the facts. State Farm Mut. Auto. Ins. Co. v. McLaughlin, 30 F.3d 861, (7th Cir. 1994); Appendix, A-24-26. It's recitation ignores the disputed factual issues presented to the jury at trial; issues concerning access to the truck, means of entry to the truck, whether McLaughlin had a financial motive for burning his truck or whether he had resolved all financial problems prior to the fire, whether he told State Farm he had profitable county contracts for hauling fish or whether he told State Farm he could have gotten such contracts if his truck had not burned, whether State Farm gave McLaughlin's loss claim as much consideration as it gave its own interests, whether State Farm treated McLaughlin fairly or whether it decided to deny his claim from the outset and then used its resources to fabricate reasons for the denial, and State Farm's motives for denying the claim. Having determined anew these factual disputes, the Seventh Circuit then concludes

> "Under Indiana law, therefore, the jury could not reasonably have awarded punitive damages. The jury could, on the other hand, have found that the

> denial of coverage was unreasonable and therefore tortious or, in any event, a breach of contract."

State Farm Mut. Auto. Ins. Co. v. McLaughlin, 30 F.3d 861 (7th Cir. 1994); Appendix, A-26.

Is not such a conclusion the very purpose of the jury? Can one say in good conscience that the mandate of the seventh amendment has been honored when an appellate court opines what a jury could or could not have concluded? Have the mandates of this Court been adhered to when an appellate court weighs evidence and substitutes its judgment for that of a jury? Is it the wish of this Court that its "no evidence" standard of review for sufficiency of the evidence challenges be replaced by judges on appeal who determine, without hearing the evidence or observing the demeanor of the witnesses, what a "reasonable" jury should decide?

This Court struck the balance between a litigant's constitutional right to trial by jury and the due process right of review of such decisions almost fifty (50) years ago. The "complete absence of probative facts" standard announced in Lavender v. Kurn must be repeated now with unequivocal clarity if justice is to be done and the seventh amendment to the Constitution is to be preserved. It is time for just such a pronouncement from this Court.

II.

A SERIOUS CONFLICT EXISTS BETWEEN THE CIRCUIT COURTS OF APPEALS AND THIS COURT AS TO THE PROPER STANDARD OF REVIEW OF JURY VERDICTS IN LIGHT OF THE SEVENTH AMENDMENT.

A variety of circuits have strayed from the standards announced by this Court when they review a civil jury verdict or a trial court's ruling on a motion for judgment n.o.v. The First Circuit, Third Circuit and Fourth Circuit Courts of Appeal have substituted their judgment for that of the jurors by applying a "reasonable person" or "reasonable jury" standard. Plante v. Hobart Corp., 771 F.2d 617 (1st Cir. 1985); Powell v. J. I. Posey Co., 766 F.2d 131 (3rd Cir. 1985); Bristow v. Daily Press, Inc., 770 F.2d 1251 (4th Cir. 1985). The Fifth Circuit has held that jurors are limited in their assessment of witness demeanor and that they are not at liberty to infer or conclude that a witness was lying. Serdenstein v. National Medical Enterprises, Inc., 769 F.2d 1100 (5th Cir. 1985). That circuit also appears to have rejected the "no evidence" standard of review formulated by this Court in favor of one which allows it to weigh the evidence to see if the verdict is against the "great weight" of the evidence. Perry v. Stewart Title Co., 756 F.2d 1197, 1205-06 (5th Cir. 1985).

The Seventh Circuit, Tenth Circuit and Eleventh Circuit Courts of Appeal reweigh all the evidence, not

only the evidence which supports the verdict, to determine what "reasonable men" should have concluded. Crawford v. Edmonson, 764 F.2d 479, 487 (7th Cir. 1985); Walden v. United States Steel Corp., 759 F.2d 834, 837 (11th Cir. 1985); Keiser v. Coliseum Properties, Inc., 764 F.2d 459 (11th Cir. 1985); Western Plains Service Corp. v. Ponderosa Dev. Corp., 769 F.2d 654, 656 (10th Cir. 1985) The prohibition against such reviews is historically well-rooted in the decisions of this Court. Gunning v. Cooley, 281 U.S. 90, 94 (1930); Dennis v. Denver & R.G.W. R.R., 375 U.S. 208, 210 (1963).

Within the last ten (10) years, a majority of the Circuit Courts have utilized their own methodology and standards for the review of jury verdicts. Common to each circuit, however, is its departure from the seventh amendment prohibition against a re-examination of jury determined facts and its disregard for the standards announced by this Court. These conflicts should be resolved now by this Court's issuance of the Writ.

CONCLUSION

This Court is the last resort for the safeguard of constitutional rights. It is the court of first resort for correction of circuit court appellate errors. Both of these functions are called into play in this case. The seventh amendment right to trial by jury means nothing unless this Court exercises its power to preserve the Constitution. The extent to which the circuit courts have eroded that right demands that this Court do so.

For the reasons and authorities stated herein, Bud McLaughlin prays that a writ of certiorari issue to review the judgment and opinion of the Court of Appeals for the Seventh Circuit which reversed the verdict and judgment awarding punitive damages to him entered in the United States District Court for the Northern District of Indiana, Hammond Division.

Respectfully submitted,

ENSLEN, ENSLEN & MATTHEWS

BY:_____

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APPENDIX

JURY TRIAL - 6TH DAY: Parties present as previously noted. Parties make record as to instructions. Jury in attendance.

COURT'S INSTRUCTIONS No. 1 through 32, both inclusive.

NOTE from Jury 2:33 p.m.

NOTE to Jury 3:15 p.m.

VERDICT: in favor of the plaintiff and against the defendant and award plaintiff compensatory damages in the amount of $26,592.00. In favor of the plaintiff and award plaintiff punitive damages in the amount of $150,000.00. Jury is polled with no change in verdict and is discharged. Clerk ORDERED to enter judgment on the Jury Verdict.

ANDREW P. RODOVICH, Magistrate Judge (Karen Price, Court Reporter)

EOD 1/12/93 jrh

CLERK'S JUDGMENT on Jury Verdict entered. cps: cnsl
(Interest rate is 3.67%)

EOD 1/12/93 jrh

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
CHICAGO, ILLINOIS 60604

JUDGMENT - WITH ORAL ARGUMENT

DATE: July 26, 1994

BEFORE: **Honorable** Daniel A. Manion,
Circuit Judge
Honorable Michael S. Kanne,
Circuit Judge
Honorable Hubert L. Will, District Judge*

No. 93-1428

BUD MCLAUGHLIN, *Plaintiff - Appellee*

v.

STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY, *Defendant - Appellant*

Appeal from the United States District Court for the Northern District of Indiana, Hammond Division
No. 91 C 353, Andrew P. Rodovich, Magistrate Judge

The judgment of the District Court is AFFIRMED in part, REVERSED in part, in accordance with the decision of this court entered on this date. Each party is to bear their own costs.

*The Honorable Hubert L. Will, District Judge of the United States District Court for the Northern District of Illinois, is sitting by designation.

(1061-110393)

In the

UNITED STATES COURT OF APPEALS

For the Seventh Circuit

No. 93-1428
BUD MCLAUGHLIN,

Plaintiff-Appellee,

v.

STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY,

Defendant-Appellant.

Appeal from the United States District Court for the Northern District of Indiana, Hammond Division.
No. 91 C 353-**Andrew P. Rodovich,** *Magistrate Judge.*

ARGUED NOVEMBER 10, 1993
DECIDED JULY 26, 1994

Before MANION and KANNE, *Circuit Judges,* and WILL, *District Judge.**

WILL, *District Judge.* In this case, we review a jury's award of compensatory and punitive damages in a breach of insurance contract case. In light of the Indiana Supreme Court's recent discussion of the Indiana punitive damages standards in *Erie Ins. Co. v. Hickman,* 622 N.E.

2d 515 (Ind. 1993), and for the reasons articulated below, we reverse the jury's award of punitive damages.

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* The Honorable Hubert L. Will, District Judge of the United States District Court for the Northern District of Illinois, is sitting by designation.

I.

BACKGROUND

In February 1990, plaintiff Bud McLaughlin purchased a new International flatbed truck for a cash price of $28,950.00 plus financing. He made improvements to the truck totaling $13,692.00 so that it could be used in his business, which involved hauling fish for stocking lakes. Also, in February, 1990, McLaughlin purchased from defendant State Farm Mutual Automobile Insurance Company ("State Farm") a policy on his new truck. In early October 1990, McLaughlin requested a suspension of insurance coverage since his truck would be in storage for the winter. After discussion with his State Farm agent, he decided to retain the comprehensive coverage, but to suspend all other coverage.

On October 13, 1990, the truck was totally destroyed by fire. Two days later, McLaughlin contacted his State Farm agent to report the incident and to file an insurance claim. At the time of the fire, the truck was being stored in an A-frame structure at a development known as Birdland in Roselawn, Indiana, where McLaughlin lived in a house trailer.

McLaughlin's State Farm agent reported the loss to the State Farrn Claims Office, which assigned claims

representative Brian Biery to gather the relevant facts and investigate the claim. Biery examined the file, arranged to take McLaughlin's statement, authorized a credit check, ordered appropriate reports, corresponded with McLaughlin, and assigned an estimator to inspect the damaged vehicle. Claims estimator Bill Siegfried inspected the truck, took photographs, and reported that the truck was a total loss.

After receiving this report, Biery contacted Herb Miller & Associates ("Miller"), fire and arson investigation experts, to obtain a cause and origin report on the fire and an investigation of a possible motive. Miller reported that the drive shaft, which was damaged and lay in pieces on the ground, had most likely exploded in the fire. Miller further reported that the fire was incendiary, that it started from inside the locked vehicle, and that there were no signs of forced entry.

During their first interview, McLaughlin informed Biery that on the day before the fire he had made arrangements to meet several of his friends for a deerhunting trip out of town. McLaughlin was to meet his first friend--Melvin "Sonny" Dobson--at Fish-A-While Lake, a "pay lake" stocked with fish open to the public where one pays a fee to fish on the lake. When McLaughlin arrived at Fish-A-While, he received a message that Dobson had been called into work for a few

hours.[1] McLaughlin then decided to go to a local tavern--Pioneer II--to kill some time.

According to McLaughlin's original statement to Biery, Dobson met him at the bar at approximately 11:00 p.m., and they then traveled together to a restaurant at the intersection of Routes 10 and 41, where they were to meet another friend--Gene Perry. This restaurant was located approximately three miles from Birdland, where the truck was stored. When, according to McLaughlin's statement to Biery, Perry arrived at approximately 11:30 p.m., they all departed for the hunting site in Attica, Indiana.

At approximately 1:00 or 1:15 a.m., a county police officer discovered the fire at Birdland and alerted the fire department. McLaughlin, who was not informed of the fire, and the other gentlemen remained at the hunting site until mid-morning the next day. Perry and McLaughlin then drove back to Birdland so that Perry could fish on the pay lake and so that McLaughlin could travel to Fort Wayne to visit his son. Upon their arrival at Birdland around noon on October 13, 1990, McLaughlin was informed by a tenant who also lived on the Birdland

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[1] Apparently, this statement was initially contradicted by Roger Clark, who claimed that McLaughlin never received a message from Dobson at Fish-A-While Lake. However, at trial Clark changed his statement and recalled that he did indeed deliver to McLaughlin the message from Dobson.

property that his truck had burned during the night.

In the interview, McLaughlin also reported to Biery that he had the only set of keys to the locked vehicle at the time it burned. According to State Farm, he further informed Biery that he was behind on his truck payaments and the he planned to obtain a loan from several relatives for the payments

He also told Biery that several days before the fire he had forced three trespassers off the Birdland property and that the trespassers had threatened to get even with him. Apparently, McLaughlin speculated that the trespassers may have started the fire. McLaughlin said he had removed the battery from the truck before the fire because he was afraid that the trespassers might steal it.[2] Although McLaughlin told Biery that he met Perry at the truckstop at approximately 11:30 p.m., Perry at least initially told Biery that he worked until midnight and thus could not have met McLaughlin until at least 12:30 or 12:45 a.m.

McLaughlin was provided with an Affidavit of Vehicle Fire, which he completed and returned to State Farm on October 30, 1990. The affidavit stated that he

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[2] Apparently, McLaughlin informed the fire chief that he had removed the battery for a different reason: to store it during the winter.

was claiming a loss of $43,000.00 on the truck, that a balance of $25,866.74 remained due to Navistar Financial ("Navistar"), who financed the purchase of the truck. The total purchase price for the truck plus the special fish-hauling equipment on it was $44,089.50, of which approximately $20,397.50 was financed through Navistar.

McLaughlin also authorized State Farm to receive information concerning his finances. Biery requested Equifax, a credit investigation company, to conduct the necessary background and credit check. Biery was informed by Equifax that McLaughlin was in arrears for a total of $5,121.00 on court-ordered support payments to his ex-wife. The credit check revealed that McLaughlin owed $516.00 to Gainer Bank for payments on a van, and that he had a $233.00 delinquency on a J.C. Penney charge card.

In January, 1991, State Farm took a sworn statement from McLaughlin. In this sworn statement, McLaughlin denied having any outstanding credit card debt. He also led Biery to believe that he had several profitable contracts with the county for 1991 which would have generated significant income from the truck. Biery's investigation, however, revealed that when McLaughlin purchased the truck in February 1990, he had already missed the deadlines for bidding on these county contracts.

McLaughlin also stated during this interview that he had used his ex-wife's truck to haul fish on October

12, 1990 because his own truck was in storage.[3] McLaughlin informed Biery that the only footprints around the truck after the fire were his own and the traffic he had permitted the previous day. It was during this interview that State Farm learned for the first time that McLaughlin had made two previous claims for fire losses.[4]

Following this sworn interview, Biery went personally to Birdland to inspect the accident scene. He there met Nick Yacuk, who informed him that he was in the process of repossessing McLaughlin's house trailer because McLaughlin was delinquent in making his required payaments. Biery also discovered that the fire department actually received the fire alarm at 1:25 a.m., and arrived at the scene at 1:32 a.m. on October 13, 1990.

State Farm took additional recorded statements from Betty McLaughlin, the plaintiff's ex-wife, Dobson; Perry; Russell Neswick, the plaintiff's lawyer and the owner of Birdland; and Yacuk, who had sold the plaintiff

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[3] During a later interview with Biery, McLaughlin's ex-wife initially denied that she lent her truck to McLaughlin on October 12, 1990; however, she later stated that she was unsure of the dates and could not remember whether he used her truck or his own.

[4] In 1981, McLaughlin reported a 1977 van stolen, and it was later recovered burned. State Farm paid that claim. In 1981, McLaughlin was investigated by the fire department in connection with a fire at Fish-A-While Lake in a building which he was leasing at the time.

the house trailer in which he resided at Birdland and was repossessing it. In Dobson's January 1991 sworn statement, he claimed that he met McLaughlin at 10:50 p.m. on October 12, 1990; his earlier statement suggested that he met McLaughlin at 10:00 p.m., and that they met Perry at 11:00-12:00 p.m. His new statement claimed that they arrived at the hunting site at approximately 1:30 or 1:45 a.m. Biery apparently became suspicious because the times in the sworn statement conflicted with Dobson's earlier statements.

Shortly thereafter, Neswick informed State Farm that he was representing McLaughlin and that "we assume your company suspects Mr. McLaughlin of committing arson" and suggested a polygraph test. Although State Farm agreed to consider the results of such a test, it is unclear whether any such test was actually performed. State Farm continued to investigate the incident. Miller advised Biery that at the time of the fire the doors were closed and there was no evidence of a break-in.

The county fire department similarly advised Biery that there were no signs of a forced entry. The state fire marshall found the cause and origin of the fire to be a liquid accelerant in the interior of the vehicle; his report similarly indicated that there was no vandalism or other sign of forced entry into the vehicle. All of these reports noted that the battery and radio had been removed from the vehicle prior to the fire.

On February 14, 1991, Biery issued a report which

recommended that McLaughlin's claim be denied. His report was submitted to a claim review committee, which considered it and also recommended denial of the claim. The claim review committee forwarded the file and their recommendation to State Farm's corporate headquarters for review. State Farm's corporate headquarters agreed and, on February 16, 1991, forwarded to Biery the decision to deny the claim.

On the same day, Biery informed Neswick that the McLaughlin claim had been denied. He confirmed this decision in a letter which stated that the reasons for denial were McLaughlin's "concealment ...misrepresentation...and that the policy definition of a loss had not been met because the fire was not accidental in nature." Tr. at 1071-74. On March 14, 1991, however, State Farm sent Navistar a check to settle the lienholder's claim.

McLaughlin filed suit against State Farm in state court, seeking compensatory and punitive damages. Count I alleged that State Farm had breached the contract of insurance by failing to pay him the value of his truck and the special fish-hauling equipment which was destroyed in the October 13, 1990 fire. Count II alleged that State Farm's conduct in its handling and denial of McLaughlin's fire loss claim constituted fraud, malice, gross negligence, or oppression thereby entitling McLaughlin to recover punitive and/or exemplary damages. State Farm removed the action to federal court and both parties consented to trial before a

magistrate judge.

State Farm filed a motion for partial summary judgment, seeking dismissal of the claim for punitive damages on the ground that there was no evidence to support a claim that State Farm's alleged breach of contract in denying the claim rose to the level of a tort. The motion was denied. Prior to the commencement of trial, State Farm moved to bifurcate the claim for compensatory damages from the claim for punitive damages primarily because of the potential prejudice from the evidence relating to punitive damages. This motion was also denied.

A jury trial was held from January 4 to 12, 1993. State Farm's motions for judgment on the evidence and directed verdict were denied. The jury returned a verdict in favor of McLaughlin, awarding compensatory damages of $26,592.00 and punitive damages of $150,000.00. State Farm now appeals from the jury's award of compensatory and punitive damages, and from the denial of its various motions.

The district court had subject matter jurisdiction pursuant to 28 U.S.C. § 1332(a) and we have jurisdiction to consider this appeal pursuant to 28 U.S.C. § 1291. While there is some dispute regarding the issues to be considered on appeal, they are best framed as follows:

A. Whether the district court erred in denying State Farm's motion for summary judgment;

B. Whether the jury was properly instructed on

the issue of punitive damages;

C. Whether, under Indiana law, the evidence was sufficient to sustain the award of punitive damages; and

D. Whether the district court abused its discretion by denying State Farm's motion to bifurcate the issues of compensatory and punitive damages.

In light of the discussion below, we affirm the award of compensatory damages and reverse the award of punitive damages.

II.

DISCUSSION

A. Summary Judgment Was Properly Denied

State Farm argues on appeal that its motion for summary judgment on the issue of punitive damages was erroneously denied on the ground that the issue of State Farm's bad faith presented a triable question of fact. This Court reviews *de novo* a grant or denial of summary judgment. *Carston v. County of Cook*, 962 F.2d 749, 751 (7th Cir. 1992); *Pro-Eco, Inc. v. Board of Comm'rs of Jay County, Ind.*, 956 F.2d 635, 637 (7th Cir. 1992). It is well established that summary judgment is only appropriate where the court can determine that "there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed. R.Civ. P. 56(c).

In reviewing a district court's decision to grant or deny summary judgment, this Court must view the record and all inferences drawn from it in light most favorable to the party opposing the motion. *Karazanos v. Navistar Intern. Transp. Corp.*, 948 F.2d 332, 335 (7th Cir. 1991)(citing *Lohorn v. Michal*, 913 F.2d 327, 331 (7th Cir. 1990)). Additionally, where the substantive law mandates a "clear and convincing" standard of proof, as in this case, the court in disposing of a summary judgment motion must consider whether a reasonable factfinder could conclude that the plaintiff had sufficient evidence to meet that burden. *Anderson v. Liberty Lobby*, 477 U.S. 242, 251 (1986).

On October 1, 1992, State Farm moved for summary judgment on the issue of punitive damages, arguing that its investigation of McLaughlin's claim was done in good faith and that punitive damages were thus unavailable. In his memorandum opposing summary judgment, the plaintiff argued that he was entitled to punitive damages because State Farm:

> breached the contract of insurance with [McLaughlin], the breach was tortious in nature in that it caused undue economic harm to [McLaughlin] of which State Farm was aware at the time of the acts complained of herein, because State Farm acted in bad faith toward its insured in the claim handling, investigation and denial of [McLaughlin's] loss claim, because State Farm disregarded its own policy and claim-handling procedures, and because State Farm willfully and wantonly–violated the duty imposed upon it by state law by refusing to communicate with [McLaughlin] concerning the handling of his claim, the factual basis for its denial of his claim, and the factual basis upon which it raised policy defenses in order to deny [McLaughlin's]loss claim.

Pl.'s Mem. Opp'n Summ. J. at 1-2. In opposition to the motion for summary judgment, McLaughlin contended that the facts and inferences to be drawn from those facts

not only showed bad faith on the part of State Farm, but also showed malice, gross negligence, and fraudulent or oppressive conduct.

In denying the motion for summary judgment, the district court found that "[a]lthough State Farm had some reasons to suspect that McLaughlin may have started the fire, whether State Farm's investigation was conducted in good faith is a question of fact for the jury." Br. of Appellant, Ex. B-3 at 5. On appeal, State Farm contends that bad faith alone is not sufficient to support a claim for punitive damages and that the motion should therefore have been granted. State Farm further argues that even if bad faith was enough to support the claim, no inference of bad faith could possibly be drawn because the district court concluded that the insured had "*some* reason" to suspect arson by the insured.

The Indiana Supreme Court in two recent cases has clarified Indiana law regarding the recoverability of punitive damages in a breach of contract case. In *Miller Brewing Co. v. Best Beers of Bloomington, Inc.*, 608 N.E.2d 975, 984 (Ind. 1993), the court held that "to recover punitive damages in a lawsuit founded upon breach of contract, the plaintiff must plead and prove the existence of an independent tort of the kind for which Indiana law recognizes that punitive damages may be awarded." The Indiana Supreme Court explained:

> Although the notion that punitive damages are avail-able in contract actions where there is "tort-like" conduct has been cited in

> all cases of this Court which address the issue of punitive damages since *Vernon Fire* was decided, in fact, such an exception has never been applied by this Court. In fact, where punitive damages were affirmed in a breach of contract case, this Court has found evident of an independent tort. ...After further consideration of *Vernon Fire* and the results in subsequent cases, we conclude that the language in *Vernon Fire* was *dicta* when it suggested that punitive damages are available in contract actions even if the plaintiff does not also establish each element of a recognized tort for which Indiana law would permit the recovery of punitive damages...[S]uch a notion rests on an unwise policy.

Id. at 982-83.

Best Beers, however, did not involve an alleged breach of an insurance contract. But after *Best Beers* it appeared that only an independent tort, such as fraud or constructive fraud, would support a claim for punitive damages.

The Indiana Supreme Court, in a more recent decision, has specifically considered the requirements for punitive damages in an insurance contract case. In *Erie Ins. Co. vs. Hickman*, 622 N.E.2d 515 (Ind. 1993), the

court reviewed a decision by the Indiana Court of Appeals which had reversed a jury verdict awarding punitive damages to the plaintiffs. In the course of its opinion, the court discussed the Indiana history of punitive damages awards in breach of insurance contract cases.

After discussing *Vernon Fire & Casualty Ins. Co. v. Sharp*, 349 N.E.2d 173 (Ind. 1976), and *Best Beers, supra*, the court in *Erie* first pointed out that *Best Beers* did not involve insurance. As a result, the decision did not address the question of whether under Indiana law a tort remedy is available to an insured when an insurer fails to fulfill duties imposed upon it by law and held that under Indiana law "recognition of a cause of action for tortious breach of an insurer's duty to deal with its insured in good faith is appropriate." 622 N.E. 2d at 519. It concluded, however, that "a good faith dispute about the amount of a valid claim or about whether the insured has a valid claim at all will not supply the grounds for a recovery in tort for the breach of the obligation to exercise good faith. This is so even if it is ultimately determined that the insurer breached the contract." *Id.* at 520.

With respect to punitive damages, the Indiana Supreme Court was very specific, saying "Punitive damages may be awarded only if there is clear and convincing evidencing that the defendant 'acted with malice, fraud, gross negligence or oppressiveness which was not the result of a mistake of fact or law, honest error or judgment, over-zealousness, mere negligence or other human failing, in the sum [that the jury believes] will serve

to punish the defendant and to deter it and others from like conduct in the future.'" *Id.* (quoting *Brad Wolf Chevrolet, Inc. v. Robertson*, 519 N.E.2d 135, 137-38 (Ind. 1988)). The court went on to say, "Thus, the mere finding by a preponderance of the evidence that the insurer committed the tort will not, standing alone, justify the imposition of punitive damages." *Id.*

After reviewing the evidence in *Erie,* the Indiana Supreme Court concluded that the jury could not reasonably have found by clear and convincing evidence that Erie, the insurer, had acted maliciously, fraudulently, oppressively or with gross negligence in denying the insured's claim. Accordingly, it affirmed the appellate court's reversal of the award of punitive damages to the plaintiff.

It is obvious from the foregoing that determination of whether an insurer has committed a tort in addition to breaching its contract, and whether its conduct was sufficiently egregious to warrant the imposition of punitive damages under Indiana law, involves both questions of fact and mixed questions of fact and law. It is also obvious that in this case there were substantial disputes about material facts and inferences to be drawn from circumstantial evidence. It follows, then, that the denial of State Farm's motion for summary judgment was not erroneous.

B. The Jury Was Not Properly Instructed

In a diversity case such as this, state law determines the proper jury instructions. *Simmons, Inc. v.*

Pinkerton's, Inc., 762 F.2d 591 (7th Cir. 1985). As noted above, Indiana law requires that each of the elements of an independent tort plus egregious conduct involving malice, fraud, gross negligence, or oppressiveness which was not the result of a mistake of fact or law, honest error or judgment, mere negligence or other human failing be proved by clear and convincing evidence in order for a jury to return a verdict of punitive damages.

"On review of a challenge to the sufficiency of the jury instructions, the question is not the correctness of a single phrase, but whether the instructions as a whole were sufficient to inform the jury correctly of the applicable law and the theory of defense." *United States v. Villarreal,* 977 F.2d 1077, 1079 (7th Cir. 1992), *cert. denied,* _U.S. , 113 S. Ct. 1350 (1993). *See also Doe v. Burnham,* 6 F.3d 476, 479 (7th Cir. 1993). Thus, in reviewing a claim of error in the jury instructions, we must "look to the instructions as a whole, in a common sense manner, avoiding fastidiousness, inquiring whether the correct message was conveyed to the jury reasonably well." *Wilk v. American Medical Ass'n,* 719 F.2d 207, 218 (7th Cir. 1983), *cert. denied,* 467 U.S. 1210 (1984). *See also Sims v. Mulcahy,* 902 F.2d 524, 533 (7th Cir.), *cert. denied,* 498 U.S. 897 (1990) ("We look at jury instructions in the broad context of the entire trial including the court record, the court's rulings, the allegations set forth in the pleadings, the evidence presented at trial, as well as the opening and closing arguments of counsel.")

Moreover, an error in the jury instructions is

reversible only if it affects the substantial rights of the parties. *General Leaseways, Inc. v. National Truck Leasing Ass'n,* 830 F.2d 716, 725 (7th Cir. 1987). *See also Goldman v. Fadell,* 844 F.2d 1297, 1302 (7th Cir. 1988) (inadequacy of jury instructions is only reversible error when "the jury's comprehension of the issues is so misguided that a litigant is prejudiced"); *Vaughn v. Willis,* 853 F.2d 1372, 1376 (7th Cir. 1988) (even if a jury instruction is found to be erroneous, "we will not find reversible error absent some effect on the substantial rights of the parties").

In this case, jury instructions 10, 14, 17, 20 and 24 through 28 related to punitive damages. Instruction 24 stated:

> The plaintiff is not, however, entitled to punitive damages as a matter of right. Punitive damages are awarded in the discretion of the jury to punish a defendant for extreme or outrageous conduct, and to deter or prevent a defendant and others like him from committing such conduct in the future. When a plaintiff seeks punitive damages, as opposed to compensatory damages, based upon the willful or wanton misconduct of a defendant, the plaintiff has the burden of proving these elements by clear and convincing evidence.

Instruction 25 stated:

> Every insurance company doing business within the State of Indiana is required to act fairly and in good faith in handling claims submitted by an insured. This obligation of good faith requires an insurance company to give the insured's interest at least as much consideration as it gives its own. Punitive damages may be awarded where you find by clear and convincing evidence that the insurance company has acted in bad faith. Bad faith, as used in the context of an insurance company, merely means a failure to be open, honest and fair with the insured. The duty of good faith and fair dealing creates an obligation in the insurer not to deprive its insured of the benefits of the policy by withholding payment fraudulently, maliciously or without probable cause.

Instructions 24 and 25, particularly the latter, clearly do not correctly state Indiana law. Neither spells out the distinction between conduct which will sustain an award of punitive damages and that which will not. And Instruction 25 tells the jury that they may award punitive damages if they find that the insurance company "acted in bad faith." The Indiana cases, however, require that

the jury find by clear and convincing evidence that the insurer acted maliciously, fraudulently, oppressively or with gross negligence, not merely in bad faith. As the First District Court of Appeals recently explained, "[E]ven if the jury determines that the insurer committed a tortious breach of its duty to exercise good faith, the right of the insured to punitive damages is not automatic. Punitive damages may be awarded only if there is clear and convincing evidence that the insurer acted with malice, fraud, gross negligence, or oppressiveness which was not the result of mistake of fact or law, honest error or judgment, overzealousness, mere negligence, or other human failing." *Nelson v. Jimison,* No. 73A01-9309-CV-288, 1994 Ind. App. LEXIS 512, at *7-8 (Ind. App. Ct. May 4, 1994) (citing *Erie,* 622 N.E.2d 515).

Given the evidence in the case, that error was not harmless for it could easily have affected the jury's determination.

C. The Evidence Was Insufficient to Support Punitive Damages

The evidence does not establish clearly and convincingly that State Farm here acted with malice, fraud, gross negligence or oppressiveness which was not the result of a mistake of fact or law, honest error or judgment, overzealousness, mere negligence or other human failing. On the contrary, the evidence indicates that State Farm was provided with information by its arson investigation expert that the fire was incendiary, started from inside the truck which was locked, the doors

of the A-frame structure in which the truck was stored were locked, and there was no evidence of a break-in. McLaughlin stated that he had the only keys to the truck. The county fire department also reported that there were no signs of a forced entry and the state fire marshall who investigated the fire found it to have been caused by a liquid accelerant in the truck's interior. There was no evidence of vandalism or forced entry into the vehicle. All of the reports noted that both the radio and the battery had been removed from the truck prior to the fire.

State Farm's investigation also revealed that McLaughlin was in default in his installment payments on the truck, was in arrears a total of $5,121.00 in court-ordered payments to his ex-wife, owed $516.00 in payments on a van, and $233.00 on a J.C. Penney charge card. State Farm also learned that the house trailer in which he lived was being repossessed because he was in default in his payments on it.

McLaughlin denied the credit card debt and told the investigator that he had several profitable contracts with the county government for 1991. Investigation revealed that he had missed the deadlines for bidding on any 1991 county contracts and had none.

State Farm also learned that McLaughlin had made two previous claims for fire losses, one on a van he had reported stolen which was later recovered burned and another on a fire in a building he was leasing at Fish-A-While Lake. Finally, there were numerous discrepancies in the times McLaughlin, Dobson and Perry

said they met, when they left various places, and when they arrived at the hunting site.

While State Farm was unable to establish that McLaughlin was responsible for the apparent arson since Dobson, Perry and McLaughlin himself all ultimately recollected they were together at the hunting site at the time the fire started, it cannot be said that the insurer's conduct in investigating and denying the claim was clearly malicious, fraudulent, oppressive or grossly negligent. Under Indiana law, therefore, the jury could not reasonably have awarded punitive damages. The jury could, on the other hand, have found that the denial of coverage was unreasonable and therefore tortious or, in any event, a breach of contract.

D. The Denial of State Farm's Motion to Bifurcate

On December 29, 1992, only a few days before the trial was scheduled to begin, State Farm moved for a separate trial of the compensatory damages and punitive damages issues. This motion was denied. On appeal, State Farm argues that the court's denial of the motion was an abuse of discretion requiring reversal of the compensatory damages claim because it suffered prejudice. In short, State Farm argues that the jury in this case was unfairly prejudiced because it simultaneously heard evidence of State Farm's arson defense and McLaughlin's bad faith punitive damages claim which was based on State Farm's decision to raise an arson defense.

Under Rule 42(b) of the Federal Rules of Civil Procedure, a district court may order a separate trial of any separate issue "in furtherance of convenience or to avoid prejudice." Fed. R. Civ. P. 42(b). It is well established that the denial of a motion for a bifurcated trial should be set aside only upon a clear showing of abuse of discretion. *See, e.g., Conkling v. Turner*, 18F.3d 1285, 1293 (5th Cir. 1994); *Dixon v. CSX Transp., Inc.*, 990 F.2d 1440, 1443 (4th Cir. 1993), *cert. denied*, U.S. , 114 S. Ct. 305 (1993); *Eastridge Dev. Co. v. Halpert Assocs.*, 853 F.2d 772, 781 (10th Cir. 1988); *Gafford v. General Elec. Co.*, 997 F.2d 150, 171-72 (6th Cir. 1993); *Barr Laboratories, Inc. v. Abbott Laboratories, Inc.*, 978 F.2d 98, 105 (3d Cir. 1992); *Westergren v. Burlington N. R.R. Co.*, 969 F.2d 727, 729 (8th Cir. 1992).

There is some possible risk of prejudice in the simultaneous presentation of a contract claim and a punitive damages claim arising from an insurer's decision to raise an arson defense on the contract claim. However, the risk of such prejudice in this case was slight. In denying State Farm's motion, the trial court stated:

> First, the motion was filed on December 29th. It was not discussed at the pre-trial conference. The Plaintiff was not afforded an opportunity to respond to it prior to trial. If it was granted on the morning of trial, I believe it would unfairly prejudice the Plaintiff in the presentation of his case.

Also, substantively, I've handled at least a half a dozen cases against insurance companies such as this. Probably more. In all of those cases, the question of both actual and punitive damages has been submitted to the jury in one trial. I have not seen that there has been any prejudice either to the plaintiff or to the defendant insurance company in those cases. At least one has resulted in a plaintiff's verdict for compensatory damages alone. And at least one has resulted in a plaintiff's verdict for actual and compensatory damages. So I believe, based on past experience, the jury will be able to follow any instructions and sort out the various issues. Also, in a case such as this, there certainly is overlap between the evidence that relates to the compensatory claim and the punitive claim. In a personal injury case, if you bifurcate on the issue of liability and damages, the evidence could be packaged neatly. In a case like this with significantly overlap, I do not believe that it would significantly improve the management of the trial; and any slight advantage that might accrue to the defendant would be outweighed by the added problems of attempting to sort out the evidence.

Br. of Appellant, Ex. B-5 at 1-2.

As the trial judge explained, since the evidence usually overlaps substantially, the normal procedure is to try compensatory and punitive damage claims together with appropriate instructions to make clear to the jury the difference in the clear and convincing evidence required for the award of punitive damages. While the instructions as to punitive damages were incorrect and the evidence insufficient to warrant them, the instructions with respect to compensatory damages were correct and the evidence sufficient to sustain them on either a breach of contract or tort basis. Moreover, State Farm has failed to demonstrate any prejudice.

Accordingly, we find that the district court did not abuse its discretion in denying the motion to bifurcate.

III.

CONCLUSION

The judgment for compensatory damages is affirmed. The judgment for punitive damages is reversed.

AFFIRMED IN PART,
REVERSED IN PART.

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
CHICAGO, ILLINOIS 60604

September 8, 1994
Before
Hon. Daniel A. Manion, Circuit Judge
Hon. Michael S. Kanne, Circuit Judge
Hon. Hubert L. Will, District Judge*

Bud McLaughlin,
Plaintiff-Appellee,

No. 93-1428 v.

State Farm Mutual Automobile Insurance Company,
Defendant-Appellant.

Appeal from the United States District Court for the Northern District of Indiana, Hammond Division.
No. 91 C 353
Andrew P. Rodovich,
Magistrate Judge.

ORDER

On consideration of the petition for rehearing filed in the above-entitled cause by Appellee, all of the judges on the original panel having voted to deny the same,

IT IS HEREBY ORDERED that the aforesaid petition for rehearing be, and the same is hereby, DENIED.

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*Hon. Hubert L. Will, District Judge of the United States District Fourth for the Northern District of Illinois, is sitting by designation.